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MUNICIPAL INVESTMENTS

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by

Municipal Budgets and Accounts Branch

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Province of Ontario

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MUNICIPAL INVESTMENTS

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I INTRODUCTION

Our publication "Cash Management in Municipalities" pointed out that investment policies and practices were the last element of an effective cash management programme and the one that enables the municipality to gain monetarily from all its efforts in implementing good cash management practices.

The ability to derive significant amounts of non-tax revenue through a sound investment programme is not limited to the larger municipalities with their sophisticated computers and professional accountants. Many of the Province's towns, villages and townships and Improvement Districts have entered into the field of municipal investment with quite successful results.

The success of a municipal investment programme should not be measured entirely by the rate of return on the moneys invested. Other factors such as the ability of the system to identify quickly the maximum dollars that can be invested and the time that such investments can be held must also be considered.

This bulletin describes the various features related to a municipal investment programme and the methods of investments that should be considered in developing such a programme.

II LEGAL AUTHORITY FOR INVESTMENTS

The Statutes of Ontario contain a number of provisions that allow municipalities to invest idle funds. Each municipal treasurer should familiarize himself with these provisions to ensure that as far as possible all idle funds are considered in the overall investment programme of the municipality.

This bulletin directs attention to four specific sections of legislation most often used as the authority to invest municipal surplus funds. The comments made under each section simply serve to highlight the relevant provisions of the section. Municipal treasurers should refer to the actual legislation and if necessary consult the municipality's legal counsel before any investment action is undertaken. Copies of this legislation can be found in Appendices A, B, and C to this bulletin.

(1) Section 308 (2) of The Municipal Act.

This section allows money raised for reserve funds to be invested in such securities as a trustee may invest in under The Trustees Act.

Many municipalities use reserve funds as a source of temporary financing to meet their current operating needs. In order to meet the legal requirements of The Trustees Act the municipality must issue a promissory note that is then purchased by the reserve fund investing the money. At the maturity of the note, or on demand, the promissory note is redeemed and the investment plus the interest

earned is returned to the reserve fund.

For some municipalities the interest rate applicable to the promissory note supporting such an investment is the same rate that the municipality would have to pay to any external lending agency on the date that the note is issued. However a number of municipalities do establish an interest rate for internal borrowing that represents an average of the mid-points of its short-term borrowings and investments. In one municipality at least three quotations are required in arriving at this average mid-point interest rate.

(2) Section 312 of The Municipal Act.

This section is the one most often used by municipalities as their authority for their investment programme. This legislation provides for the acquisition of a wide range of investment instruments such as;

- 1) bonds, debentures and other evidences of indebtedness guaranteed by the Government of Canada, the Province of Ontario or any other province of Canada;
- 2) debentures, notes, guaranteed investment certificates or term deposits of any trust or loan corporation registered under The Loan and Trust Corporations Act;

- 3) term deposits, deposit receipts, certificates of deposit or similar investments issued, accepted, guaranteed or endorsed by any chartered bank to which the Bank Act (Canada) applies;
- 4) promissory notes of a metropolitan, regional or district municipality or of a municipality as defined in The Municipal Affairs Act or of a conservation authority as established under The Conservation Authorities Act. This section also provides the authority for loans to school boards;
- 5) term deposits accepted by a credit union as defined in The Credit Unions and Caisses Populaires Act, 1976 (refer to Section 36).

This last provision allowing for the investment in term deposits accepted by credit unions and caisses populaires became effective on January 31, 1979 by a proclamation issued by the Lieutenant Governor.

In addition to setting out the type of investments that a municipality can make to outside agencies, paragraph (b) allows for advances to the capital account of the municipality for the purpose of interim financing of capital projects.

All of the interest earned through investments made under the provisions of this section shall be credited to the fund from which the moneys are invested or advanced.

(3) Section 313 (1a) of The Municipal Act.

Under this section moneys received from the sale of debentures that are not immediately required for the purpose for which the debentures were issued may be invested in the general funds of the municipality. There are a number of conditions applicable to the use of these funds. These conditions are:

- (a) the municipality must have a population of not less than 20,000;
- (b) the money invested must be returned to the debenture account on the day in which the moneys are required to meet the purpose supporting the debenture issue, or;
- (c) no later than the 31st day of December of the year in which the moneys were invested; whichever occurs first.

All of the interest earned on this investment must be credited back to the debenture account. The interest rate on such investments must be equal to the rate applicable to the temporary borrowing rate of the municipality at the time the funds are drawn.

(4) Section 33 (1) of The Planning Act.

This legislation enables municipalities to invest moneys received in lieu of park land under subdivision agreements or through the subsequent sale of dedicated park land. Moneys of this nature must be invested under the conditions set forth in The Trustees Act, and all of the interest received from such investments must be credited back to the account from which the invested funds were drawn.

III ACCOUNTING FOR INVESTMENTS

Once the decision has been made to enter into an investment programme, the treasurer should review his accounting and reporting systems to ensure the accountability and reporting of all investment transactions. It is suggested that the Treasurer include in his accounting system some form of investment register. The register may be consolidated or there can be a separate register for each fund, for example, Revenue Fund and Capital Fund. The register would list all investments showing the type of investment held, e.g. term deposit, promissory note, etc.; the rate of interest; amount of the investment; date of maturity; and the projected and actual yield of the investment when sold.

IV SAFEGUARDING INVESTMENT DOCUMENTS

Every investment made will require some evidence to support the transaction. This evidence may be a receipt from a bank, a promissory note, stock certificate or any number of other legal instruments. Some of these documents may be readily negotiable for cash and therefore must be safely secured. Even documents of a non-negotiable nature must be safeguarded as they are prima facie evidence that the transaction actually occurred and will be required at the time of maturity.

If the municipal office does not have secure storage facilities such as a safe, then these documents should be stored in a safety deposit box or other such facility offered through the municipality's bank.

V INVESTMENT TERMINOLOGY

The investment community like so many others, has terminology that does not have common usage outside of that community. While it is not practical or possible to give a complete glossary of investment terminology in the bulletin, the following are definitions of the most common terms used.

Yield/Current Yield: The annual interest earned as a percent of the price of the investment.

Discount: The difference between the purchase price of a security and its value at maturity when the price is lower than the maturity value.

Face (Par) Value: The value of a security as expressed on its face without consideration to any premium or discount. It represents the dollar value on which the interest rate is applied.

Liquidity: A measure of the ability to convert a security into cash promptly with minimum risk of loss of principal or accrued interest.

Maturity: The date on which the principal or stated values of investments fall due and may be reclaimed.

Interest rate: The actual interest rate as shown on the security.

Premium: The difference between the purchase price of a security and its value at maturity when the price is higher than the face value.

Risk: The potential for loss of principal and/or accrued interest on an investment.

Yield-to-Maturity: The average annual return on an investment based on the interest rate, price, and length of time to maturity. It differs from current yield in that it takes into consideration the increase to par of an investment bought at a discount and the decrease to par of an investment bought at a premium.

VI INVESTMENT INSTRUMENTS

The following list provides information on the most common types of investments available to Ontario municipalities. The ones most preferred by municipalities are:

Term Deposits (Deposit Receipts, Term Notes or Certificates of Deposit) - evidenced by a receipt that is not negotiable and issued by chartered banks, trust companies and loan corporations with flexible terms and amounts according to the number of days desired by the investor. Normally the minimum deposit is \$5,000 with a minimum term of 30 days, but on amounts in excess of \$100,000 a minimum of one day is possible. The full amount of the deposit plus interest is returned at the time of maturity. Different interest rates are quoted depending on the length of time the money is to be invested. The standard investment periods are less than 30 days; 30 to 59 days; 60 to 89 days; 90 to 179 days; 180 to 269 days; and 270 to 364 days. Depending on current market conditions, higher interest rates may be earned for longer time spans. The term deposit may be redeemed at any time before maturity; however, the effective rate of interest will be reduced according to a predetermined earning rate stipulated by the bank, trust company or loan corporation. Usually the yield on early redemption is slightly below the rate quoted originally and as a result there is a penalty associated with over-estimating the time that the idle funds are available.

Inter-Municipal Loans - Section 312 (2) (iv) of The Municipal Act permits municipalities to invest in promissory notes of other municipalities, school boards and conservation authorities when established under The Conservation Authorities Act. This type of

investment has not gained wide prominence in Ontario and at present is used by only a small number of municipalities, mainly the larger cities and regions. Nevertheless such investments can be quite attractive to any municipality and should not be overlooked by municipal Treasurers. Investments of this nature are arranged through personal contact between the Treasurers of the municipalities involved who then agree on the size of the loan, repayment dates and the rate of interest on the loan. The net interest rate of return on this type of investment is often greater than the current market rate due to the elimination of the commission fees normally charged by the brokerage firms. Treasurers should be aware of any service charges, such as bank transfer costs, that may occur and adjust the interest rate to cover any such costs. Transfers can be arranged through the municipality's bank or by the issuance of a cheque in those circumstances where time permits. All loans as stated in the legislation must be secured by a duly authorized promissory note.

Other forms of investments available to municipalities are:

Bearer Deposit Notes - are issued periodically by chartered banks in multiples of \$100,000 being secured by the bank's general credit. The Notes are sold at a discount to mature at par, with terms ranging from 7 to 364 days as determined by the issuing bank. While these may on occasion be purchased by a municipality directly from the issuing bank, the normal arrangement is that these Bearer Notes are acquired by the various investment dealers or other chartered banks who handle the trading to third parties. The municipality can thereby arrange the term of investment to suit its

availability of funds irrespective of the maturity date of the Note (dealers frequently enter into a buy back or repurchase agreement to accommodate shorter terms of the investor).

Bankers' Acceptances - are essentially a commercial draft drawn by a corporate borrower for payment on a specified date and guaranteed by countersignatures on the actual drafts. Bankers' Acceptances issued at a discount payable at par are limited generally to a period not exceeding 90 days. Acceptances are created in multiples of \$100,000. These are normally purchased from an investment dealer and enjoy a fairly active market. If necessary the investor can usually specify call features at the time of purchase. All Bankers' Acceptances, wherever issued, are payable at maturity at the main offices of the accepting bank in both Toronto and Montreal. Municipal investors normally arrange to have the note presented on their behalf by the investment dealer. The guarantee by a chartered bank permits municipalities to acquire these securities.

Canada Treasury Bills - in denominations of \$1,000; \$5,000; \$25,000; \$100,000 and \$1 million are issued each week by the Bank of Canada, as Agents for the Federal government. The normal terms at issuance are for 91 or 182 days, but occasionally terms extend to 270 and 364 days. These Bills are available in bearer form only and are sold at a discount to mature at par. These Bills are acquired initially by investment dealers and banks and can be acquired by municipal investors from these agencies to suit their required maturities, similar to Bearer Deposit Notes.

Provincial Treasury Bills - are issued periodically by the majority of provinces or crown agencies of the province (i.e.: Ontario Hydro) generally in \$25,000 denominations. Some are sold at a discount and others bear a fixed rate of interest. As in the case of Bearer Deposit Notes and Federal Treasury Bills these are normally bought from investment dealers and banks who maintain an inventory of these money market instruments.

Municipal Notes - or municipal treasury bills are becoming more prevalent amongst the major Canadian municipalities as a convenient source of temporary financing. These promissory notes are issued generally in denominations of \$100,000 or multiples thereof, with terms less than 90 days. Liquidity of these notes may be more restricted as compared to Federal or Provincial Treasury Bills.

Provincial and Canada Bonds - also form an active part of the short-term money market as the long-term debt approaches maturity. Investment dealers and chartered banks can supply quotes and advice on availability of these instruments. Municipalities acquiring these securities normally retain the investment until maturity.

Bank Swap Deposits - are not too common to the municipal investor because the decision to buy must be made quickly plus the fact that they are arranged on a transaction basis makes the instrument totally non-liquid until maturity. In this investment, Canadian dollars are converted into U.S. term deposits, but at the same time as the agreement is consummated Canadian dollars are purchased in the forward money market as a hedge against any future exchange rate fluctuations.

While the conversion process is rather complex, this is handled completely by the chartered bank or investment dealer with the result that the Canadian investor is quoted an all inclusive yield guaranteed by the bank, which includes both the U.S. term rate and the yield effect of the swap in currencies. This instrument may be obtainable in \$100,000 denominations, but generally requires a much higher investment level. At certain times, these Deposits may be more attractive than the return available from domestic investments; therefore, when large cash surpluses are available this form of investment should be reviewed.

VII CONCLUSION

The preceding summarizes the basic characteristics of the investment instruments that confront the municipal Treasurer entering the short-term money market.

A sound investment program provides the municipality with the opportunity to increase their total income through this form of non-tax revenue. This type of program is not without risk. Investments placed with financially weak organizations can result in the loss, or reduction, of anticipated interest and in some cases the loss of all or part of the principal invested. Treasurers, particularly those entering the investment field for the first time, should follow the old adage "investigate before you invest".

The municipality's banker is normally an excellent source of investment advice as are a number of investment dealers and trust companies. The sources for obtaining sound investment advice are there, it is only necessary for the Treasurer to seek them out.

Appendix AMUNICIPAL INVESTMENTSInvestment Provisions UnderThe Municipal Act

308.-(2) The moneys raised for a reserve fund established under subsection 1 shall be paid into a special bank account and may be invested in such securities as a trustee may invest in under The Trustee Act, and the earnings derived from the investment of such moneys form part of the reserve fund.

312.-(1) For the purposes of this section, "municipality" includes a metropolitan, regional or district municipality.

(2) Where a municipality has moneys not required immediately by the municipality, such moneys may be,

(a) invested in,

- (i) bonds, debentures, or other evidences of indebtedness of or guaranteed by the Government of Canada, the Province of Ontario, or any other province of Canada,
- (ii) debentures, notes or guaranteed investment certificates of or term deposits with any trust company or loan corporation that is registered under The Loan and Trust Corporations Act,
- (iii) term deposits, deposit receipts, deposit notes, certificates of deposit, acceptances and other similar instruments issued, accepted, guaranteed or endorsed by any chartered bank to which the Bank Act (Canada) applies,
- (iv) promissory notes of a metropolitan regional or district municipality, or of a municipality as defined in The Municipal Affairs Act, or of a conservation authority established under The Conservation Authorities Act,
- (v) term deposits accepted by a credit union as defined in The Credit Unions and Caisses Populaires Act, 1976; or

(b) advanced to the capital account of the municipality for the purpose of interim financing of capital undertakings of the municipality,

provided that the investments or advances to the capital account become due and payable by the day on which the moneys are required by the municipality, and all interest thereon shall be credited to the fund from which the moneys are invested or advanced.

Appendix A (cont'd)

313.-(1a) Notwithstanding subsection 1 of this section and section 320, where a local municipality having a population of not less than 20,000, as determined under The Ontario Unconditional Grants Act, 1975, has moneys received from the sale of debentures that are not required immediately for the purpose or purposes for which the debentures were issued, such moneys may be invested in the general fund of the municipality, provided that such moneys shall be returned to the debenture account,

- (a) by the day on which the moneys are required for the purpose or purposes for which the debentures were issued; or
- (b) not later than the 31st day of December of the year in which the moneys were so invested,

whichever the first occurs and interest shall be credited to the debenture account on the amount so invested, at a rate equal to the rate currently applicable to the temporary borrowings of the municipality.

Appendix BMUNICIPAL INVESTMENTSInvestment Provisions UnderThe Planning Act

33.-(11) All moneys received by the municipality under subsections 8 and 10 and all moneys received on the sale of land under subsection 9, less any amount expended by the municipality out of its general funds in respect of such land, shall be paid into a special account, and the moneys in such special account shall be expended only for the acquisition of lands to be used for park or other public recreational purposes, for the development or improvement of lands used or to be used for park or other public recreational purposes, including the erection or repair of buildings or other structures thereon or for the maintenance of lands, buildings or structures used for park or other public recreational purposes, including the acquisition of machinery and equipment required for such maintenance, and the moneys in such special account may be invested in such securities as a trustee may invest in under The Trustee Act and the earnings derived from the investment of such moneys shall be paid into such special account, and the auditor in his annual report shall report on the activities and position of the account.

MUNICIPAL INVESTMENTSInvestment Provisions UnderThe Trustee Act

26. A trustee may invest any trust money in his hands in the classes of securities mentioned in this section, but only if the investment is in other respects reasonable and proper,

- (a) bonds, debentures or other evidences of indebtedness,
 - (i) of or guaranteed by the Government of Canada,
 - (ii) of or guaranteed by the government of any province of Canada,
 - (iii) of or guaranteed by the Government of the United Kingdom,
 - (iv) of any municipal corporation in Canada, including debentures issued for public, separate, secondary or vocational school purposes, or guaranteed by any municipal corporation in Ontario, or secured by or payable out of rates or taxes levied under the law of any province of Canada on property in such province and collectible by or through the municipality in which such property is situated;
- (b) first mortgages, charges or hypothecs upon real estate in Canada;
- (c) bonds, debentures or other evidences of indebtedness of a corporation that are secured by the assignment to a trustee of payments that the Government of Canada has agreed to make, if such payments are sufficient to meet the interest as it falls due on the bonds, debentures or other evidences of indebtedness outstanding and to meet the principal amount of the bonds, debentures or other evidences of indebtedness upon maturity;
- (d) debentures of any loan corporation that is registered under The Loan and Trust Corporations Act;

Appendix C (cont'd)

- (e) guaranteed investment certificates of any trust company that is registered under The Loan and Trust Corporations Act;
- (f) bonds, debentures or other securities issued or guaranteed by the International Bank for Reconstruction and Development established by the Agreement for an International Bank for Reconstruction and Development approved by the Bretton Woods Agreement Act (Canada), if the bonds, debentures or other securities are payable in the currency of Canada or the United States of America;
- (g) deposit receipts, deposit notes, certificates of deposits, acceptances and other similar instruments issued or endorsed by any chartered bank to which the Bank Act (Canada) applies.

27. (1) In addition to the investments authorized by section 26, a trustee holding trust money for investment may invest such moneys in the following classes of investments, but only if the investment is in other respects reasonable and proper and is made in accordance with subsections 2, 3 and 4.

- (a) bonds, debentures, debenture stock or other securities of any corporation incorporated in Canada, or by any province of Canada, or by any former province now forming part of Canada, that are secured by a mortgage or hypothec to a trust company either singly or jointly with another trustee upon improved real estate of such corporation or other assets of such corporation of the classes mentioned in this section or in section 26;
- (b) bonds, debentures or other evidences of indebtedness of a corporation that are secured by the assignment to a trustee of payments that are payable, by virtue of an Act of a province of Canada, by or under the authority of the province, if such payments are sufficient to meet the interest as it falls due on the bonds, debentures or other evidences of indebtedness outstanding and to meet the principal amount of the bonds, debentures or other evidences of indebtedness upon maturity;

Appendix C (cont'd)

- (c) bonds, debentures or other evidences of indebtedness of a corporation that has paid,
 - (i) a dividend in each of the five years immediately preceding the date of investment at least equal to the specified annual rate upon all of its preferred shares, or
 - (ii) a dividend in each year of a period of five years ended less than one year before the date of investment upon its common shares of at least 4 per cent of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid;
- (d) preferred shares of a corporation that has paid,
 - (i) a dividend in each of the five years immediately preceding the date of investment at least equal to the specified annual rate upon all of its preferred shares, or,
 - (ii) a dividend in each year of a period of five years ended less than one year before the date of investment upon its common shares of at least 4 per cent of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid;
 - (iii) fully paid common shares of a corporation that, in each year of a period of seven years ended less than one year before the date of investment, has paid a dividend upon its common shares of at least 4 per cent of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid.

If you require assistance or guidance in implementing any aspect of this bulletin please contact your local office of the Field Services Branch, Local Government Division of the Ministry of Intergovernmental Affairs.

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